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THEORISING THE GOVERNANCE OF NOT-FOR-PROFITS

CHRISTOPHER A RILEY*

INTRODUCTION

Current interest in the governance of not-for-profits flows from two converging sources. One is the growing social and economic importance of such organisations, and indeed of the broader “third sector” of which they form a large part. It has been estimated, for example, that in England and Wales there are 190,000 charities alone, with a combined annual income of £38 billion.¹ This growing importance is in turn reflected in a number of recent governmental initiatives, including the creation of an “Office of the Third Sector” within the Cabinet Office² and the appointment of a Minister and a Director General for the sector.³

The second source of interest flows from the continuing attention devoted to governance in general, and to the governance of organisations in particular. The epic proportions (and gestation) of the Companies Act 2006 bear witness to that,⁴ alongside a range of other private sector⁵ and governmental initiatives.⁶ And whilst *for-profit* corporations still enjoy the greater part of this attention, reforms have increasingly addressed not-for-profits too, again with action from both government,⁷ and non-governmental bodies.⁸

That governance should have come to enjoy such prominence ought hardly to surprise us, for it addresses fundamental questions about the objectives and regulation of organisations that, in modern economies, have come to dominate our lives. Devising an appropriate governance regime for not-for-profits must proceed, however, from an understanding of the role played by such organisations within our society. This article tries to advance our thinking on that issue. The third and fourth sections examine, and evaluate, the two leading theories that have been offered to explain the role of not-for-profits, namely that they are a response to governmental failures, or that they are a response to market failure. It will be argued that although these theories are often seen as being in competition with each other, they ought rather to be seen as complementary, each adding something significant to the other. Taken together, they offer a valuable account of not-for-profits. That account remains, however, incomplete.

* Law Department, Durham University. My thanks to Alison Dunn, and to participants at the Society of Legal Scholars (Company Law subject section) for comments on earlier versions of the above. The usual disclaimer applies.

¹ See Charity Commission, *Annual Report, 2005–06* (London: The Stationery Office, 2006). For data on the “voluntary sector” (which data excludes independent schools and housing associations) see NCVO, *The UK Voluntary Sector Almanac 2006* (London: NCVO, 2006).

² The Office brings together two previous governmental initiatives: its “Active Communities Directorate” and its Social Enterprise Unit. See generally http://www.cabinetoffice.gov.uk/third_sector/.

³ (Ed) Miliband was appointed as Minister in May 2006, and Campbell Robb as Director General in October 2006. Coinciding with their appointments, the Government also launched its “Comprehensive Spending Review 2007: The future role of the Third Sector in social and economic regeneration”. See http://www.hm-treasury.gov.uk/documents/public_spending_and_services/third_sector/pss_thirdsector_policyreview.cfm.

⁴ The Act weighs in at 1300 sections, plus 16 Schedules, and is the culmination of a review process launched in 1998.

⁵ See, for example, the Financial and Reporting Council, *The Combined Code on Corporate Governance*, (June 2006), available at: <http://www.frc.org.uk/documents/pagemanager/frc/Combined%20code%202006%20OCTOBER.pdf>

⁶ Eg DTI, *Building Better Boards* (DTI, 2004), or The Directors Remuneration Report Regulations 2002, SI 2002/1986.

⁷ See eg Cabinet Office, *Private Action, Public Benefit* (Cabinet Office, 2002) which led to the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Charities Act 2006; A Dunn and CA Riley, “Supporting the Not-for-Profit Sector: The Government’s Review of Charitable and Social Enterprise” (2004) 67 MLR 632.

⁸ See for example the ICSA/NCVO, *Code of Governance for the Voluntary and Community Sector* (draft, 2005) available at <http://www.ncvo-vol.org.uk/tgt/hub?id=2327>

In particular, the explanations they give emphasise the instrumental role of not-for-profits – their ability to deliver the goods or services that the state, or for-profits, struggle to supply.

Certainly, this instrumental aspect of not-for-profits is important. Also significant, however, is the fact that not-for-profits do, and should, function as what will be called “participatory communities”. The fifth part explores this character of not-for-profits, arguing that they constitute a shared enterprise in which their various stakeholders can develop a relationship that is richer and fuller than that of a mere arms-length “consumer” of goods or services. Such participation is sometimes an end in itself, rewarding participants with a sense of belonging, of being a member of a team pursuing a collective endeavour. And sometimes it provides a means whereby participants can exercise their need to express and explore their deeply held values and commitments. The sixth part expands on how the governance of not-for-profits might respond to this participatory and expressive role, noting some concrete examples of governance measures necessitated by it. It does not, however, aim to set out a comprehensive blueprint for such a regime. That is, to be sure, an important task, but not for here. We begin, however, by addressing some definitional and conceptual issues raised by our enquiry.

SOME PRELIMINARIES

The first concerns the meaning of “not-for-profits” themselves. This seems an obvious place to begin and yet identifying the essence of such organisations demands in part the very enquiry that the remainder of this article undertakes. Still, for now we can at least say enough to provide a footing for the discussion that will follow. Not-for-profits, notwithstanding that label, should not be understood as being precluded from *making* profits.⁹ Rather what is, and should be, prohibited is the *distribution* of profits. They are, or ought to be, subject to what Hansmann calls a “non-distribution constraint”,¹⁰ or what the UK government referred to as a “lock on assets”.¹¹ It will be argued later that this negative restriction on not-for-profits tells only *part* of the story, and that as important is the *positive* obligation as to how their assets are to be used. But that discussion can wait.

We might also note that not-for-profits form a part of the broader “third sector”, a grouping of organisational types that sit between the state and the for-profit sector, and which are usually taken as including, in addition to not-for-profits, social enterprises, mutual organisations and co-operatives. Not-for-profits might themselves also be further subdivided into different types. So, for example, some – but by no means all – not-for-profits will also be charities (within the definition of the Charities Act 2006, section 1).¹² Further, they may also take a variety of *legal forms*: as trusts, unincorporated associations, or corporate bodies. This article concentrates upon the last of these, and uses the terms organisation and company interchangeably.

That says something of not-for-profits, but what about governance? That term is generally understood to be concerned with both the exercise, and the regulation, of power. In the corporate context, it has been defined by Parkinson as “the system

⁹ It would be quite impractical for any organisation to hit a precise “break even” point in relation to each and every transaction undertaken, or even over some accounting period.

¹⁰ See HB Hansmann, “The Role of Nonprofit Enterprise” (1980) 89 *Yale LJ* 835, 838.

¹¹ See eg Cabinet Office, *Private Action, Public Benefit*, *op cit*.

¹² The definition applies to charities in England and Wales. For Scotland, see the Charities and Trustee Investment (Scotland) Act 2005, s 7.

through which those involved in the company's management are held accountable for their performance, with the aim of ensuring that they adhere to the company's proper objectives."¹³ Governance, on this account, is distinct from, and in a sense *higher* than, the way an organisation is actually managed. Note also that the governance regime we are addressing here is one that will arise in virtue of having adopted the legal form of a not-for-profit (company). We are not concerned, then, with all the regulation that will apply in virtue of the particular area of activity (educational provision, housing, political campaigning, or whatever) that the not-for-profit happens to undertake.

Much of the theorising – both positive and normative – about not-for-profits has been drawn from economics, or from economically minded lawyers.¹⁴ Economists were, however, relatively slow in devoting attention to the not-for-profit sector. This could be seen as a consequence of the method of neo-classical economics, which tended to ignore organisations in general. The emphasis was on how *markets* operated, rather than on the internal workings of organisations. These were often regarded merely as “black boxes” that did not need to be “opened up” and explained.¹⁵ The increasing attention that has been given to not-for-profits, then, can be seen as part of a growing interest in the internal workings of firms, and of economic institutions, more generally.¹⁶

Nevertheless, the tendency has remained to view the market as the dominant, and “prior”, mechanism for producing and allocating goods or services, and to see not-for-profit organisations (and, similarly, the state) as exceptional correctives to some failing in the market. Thus, economic orthodoxy takes as its starting point a collection of atomistic individuals who act rationally in pursuit of their own self-interest. The ties that bind these individuals together are economic exchanges. Individuals trade with each other because each thinks she will be left better off by so doing.¹⁷ Such exchanges are co-ordinated by the “price mechanism”: the prices for resources (including for labour) that markets generate. Sophisticated models are then constructed to explore the end state or “equilibrium” to which this transacting will give rise under a set of conditions usually referred to as “perfect competition”. Finally, the problem of market failures – that is, situations in which the conditions of perfect competition are not realised – is introduced. Such failures undermine the process of free-exchange, preventing it from reaching the optimal end state predicted by the model of perfect competition. Institutions, such as the state, or not-for-profits,¹⁸ are then explained as a rational response to these market failures. The first theory we shall examine clearly falls into this category. Interestingly, however, it sees not-for-profits as a solution not merely to market failures, but to government failures too.

¹³ JE Parkinson, “Company Law and Stakeholder Governance” in G Kelly *et al* (eds) *Stakeholder Capitalism* (Macmillan, 1997).

¹⁴ For a useful overview of the contribution of economic analysis to the not-for-profit sector, see “Preface” in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches* (Kluwer Academic, 2003). Sokolowski has noted that the significance given to not-for-profits by economists arises because this form of enterprise seems to challenge the basic assumptions of economic analysis, namely rational choice and utility maximisation. See SW Sokolowski, “The Death Knell of Utilitarianism: A Review and Theoretical Implications of *To Profit or Not to Profit*” (2000) 11 *Voluntas* 375.

¹⁵ This point has been made many times by those writing about the economics of business (for-profit) firms; see for example OE Williamson, *The Economic Institutions of Capitalism* (The Free Press, 1985); M Krashinsky, “Stakeholder Theories of the Nonprofit Sector” in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*, at p 126.

¹⁶ See A Ben-Ner and B Gui, “Introduction” in A Ben-Ner and B Gui (eds) *The Nonprofit Sector in the Mixed Economy* (University of Michigan Press, 1993).

¹⁷ Such exchanges are usually referred to as “Pareto superior” moves: moves which leave at least one person better off, and leave no one else worse off.

¹⁸ Indeed, firms in general have been explained as a response to the transaction costs incurred in transacting across markets; see RH Coase, “The Nature of the Firm” (1937) 4 *Economica* 386.

PUBLIC GOODS AND GOVERNMENTAL FAILURE

This first theory has been particularly associated with Weisbrod, and takes as its starting point the difficulties faced by for-profit firms in supplying "public goods".¹⁹ Such goods are said to display two qualities. First, they are "non-rival", so that one person's consumption of the good does not preclude another person's consumption. The significance of this is that the cost of production does not increase with the quantity produced, so it costs no more to produce the good for many consumers as for a few. Clean air, or national defence, are commonly-cited examples. This promises a significant economic benefit, since the production of non-rival goods ought to be highly cost effective; a television programme, once made, can be consumed by millions as cheaply as by a few. The second quality of a public good is, it might be said, more of a curse. Such goods are "non-excludable": it is difficult to exclude non-payers from consuming the good or service. There is no easy way, for example, of preventing non-payers from enjoying the benefits of national defence, or of clean air. Similarly, as Slavinski notes, "[o]ne of the best examples of a pure public good is material aid to the indigent, from the point of view of the *nonrecipients* of that aid."²⁰ To be sure, the cost of aid may increase as the number of *recipients* increases, and potential recipients might easily be excluded too. However, non-recipients stand in a quite different position. My happiness that famine victims are being helped does not reduce your happiness about it. And even if you contribute nothing towards the cost of famine relief, still it is impractical to exclude you from whatever happiness you may experience.²¹

The non-excludable quality of public goods results in for-profit firms typically providing a lesser quantity of such goods than consumers collectively desire, given the modest "unit cost" of producing such goods.²² The state has often been seen as the appropriate corrective to this problem, for it can provide public goods and then *compel* consumers to pay for that provision, through its legal power to levy taxation. Weisbrod's insight, however, was to note that, in addition to the market's failure to deliver public goods, there may also be a form of "government failure" resulting in the state under-providing such goods (at least for some sections of the population). Suppose that taxpayers are heterogeneous in their demands for public goods. Some would prefer, say, more public service broadcasting, or more overseas aid, than would others. Government, argued Weisbrod, will tend to choose a level of supply that satisfies the "median voter",²³ leaving high demand taxpayers undersupplied.²⁴ This problem can be addressed to some extent through the way in which political (and

¹⁹ For an early account of this, see eg BA Weisbrod, "Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy" in ES Phelps (ed) *Altruism, Morality and Economic Theory* (Russell Sage, 1975).

²⁰ A Slavinski, "The public Goods Theory Revisited: Comments on Kingma's Revisitation of Weisbrod" in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, op cit, at p 69, emphasis in original.

²¹ This analysis assumes that the happiness which *non-recipients* experience arises just in virtue of others being helped. Where, however, a non-recipient's happiness depends on her knowing that it was *her* donation that helped the recipient, then the good is clearly excludable.

²² The extent of the failure of private, profit-seeking, firms to supply public goods is itself a matter of dispute. Coase, for example, famously showed how lighthouses, often regarded as a clear example of a public good, were privately owned in Britain (with ships being compelled to pay for them on entering ports). See RH Coase, "The Lighthouse in Economics" (1974) 17 *J of Law and Economics* 357-76.

²³ As Weisbrod makes clear, the point is that different citizens want different quantities of any given public good given the "price" that will be payable for those different levels of provision. Price here means the amount of *additional tax* that the citizen would have to pay for an increase in the quantity of that good. See the later version of his "Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy" in BA Weisbrod (ed) *The Voluntary Nonprofit Sector: An Economic Analysis* (Lexington Books, 1977).

²⁴ It will also leave "low-demand" taxpayers *over-supplied*, but whilst that may be a political problem it is not part of the explanation for not-for-profits.

therefore taxpaying) communities are constructed.²⁵ But not-for-profits, it is argued, can be understood as an alternative response. They deliver the public goods that high-demand taxpayers want but which the state, playing only to the median taxpayer, is unwilling to provide.

Weisbrod's median voter explanation for not-for-profits has been widely influential.²⁶ Aspects of the theory have been subject to empirical testing (especially in the context of the USA) and the data have been seen as reasonably supportive of Weisbrod's analysis.²⁷ So, for example, the theory predicts that, all other things being equal, there will be a greater abundance of not-for-profits where communities are more heterogeneous (and thus have more diverse demands for public goods).²⁸ Kingma suggests that the experience of the USA, with its politically, religiously²⁹ and ethnically diverse population, and its flourishing not-for-profit sector, provides at least impressionistic support for this hypothesis.³⁰ And he notes a number of empirical studies showing that heterogeneity in race, and in income, education and age, are likewise positively correlated with larger not-for-profit sectors.³¹

There are, however, two inter-related reasons for doubting the explanatory power of the "median voter" theory, particularly in its application to the UK. First, and perhaps most obviously, public spending, say as a proportion of GDP, is rather higher in the UK than in the USA. Whatever the reason for this, it suggests there may be a rather smaller gap in the UK between the current level of state provision and the aggregate demands of its citizens.³² Second, a large – and growing – proportion of not-for-profit activity in the UK is funded by the state itself.³³ This role of not-for-profits (and indeed of the broader third sector) as *deliverer* of state-funded services has been, for example, central to the current government's relationship with the sector, as reflected in a range of recent governmental publications.³⁴ Yet the median voter theory has little to say about this development, for the following reason. Where not-for-profits act as the deliverer of state funded services, the state has *already* decided to tax citizens up to the level necessary to pay for such services. The decision to use not-for-profits for their delivery must, then, be explained by something other than the state's supposed reluctance to tax and to spend more than the median voter will approve. As Slivinski put it, for Weisbrod

the not uncommon event in which the government contracts with a profit-making or nonprofit organization to provide a service and then pays the organization for that service

²⁵ See eg WE Oates, *Fiscal Federalism* (Harcourt, Brace and Jovanovich, 1972).

²⁶ For an acknowledgement of the influence of Weisbrod's analysis, see BR Kingma, "Public good theories of the non-profit sector: Weisbrod revisited" in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*.

²⁷ See the brief discussion in A Ben-Ner and B Gui, "Introduction" in A Ben-Ner and B Gui (eds) *The Nonprofit Sector in the Mixed Economy*, *op cit*, at p 9.

²⁸ See also BA Weisbrod, "The Future of the Nonprofit Sector" (1997) 16 *J of Policy Analysis and Management* 541, at pp 542–543, noting "the growing importance of nonprofits everywhere, as population migration and the flow of information through television and computers have the effect of magnifying diversity in country after country."

²⁹ On the claimed correlation between the size of the not-for-profit sector and a "religious heterogeneity index", see HK Anheier, *Nonprofit Organizations: Theory, Management, Policy* (Routledge, 2005), at pp 122–3.

³⁰ BR Kingma, "Public good theories of the non-profit sector: Weisbrod revisited" in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*.

³¹ *Ibid*, at pp 58–9.

³² It may, rather plausibly, also suggest that factors other than heterogeneity explain the level of public expenditure, which would again require some qualification of the median voter theory.

³³ See eg The Charity Commission, *Stand and deliver: The future for charities providing public services* (The Charity Commission, February 2007) ch 1.

³⁴ HM Treasury, *Exploring the role of the third sector in public service delivery and reform* (HM Treasury, 2005); Office of the Third Sector, *Partnership in Public Services: An action plan for third sector involvement* (Cabinet Office, 2006); HM Treasury, *Comprehensive Spending Review 2007*, *op cit*.

with tax dollars is counted as an instance of government provision. . . . it is worth noting that it leaves aside a whole range of questions about the choice between government production and contracting for production by the private sector.³⁵

However, whilst it is legitimate to criticise the limited significance of the median voter explanation for not-for-profits (especially for the UK), it must also be acknowledged that that explanation has now been supplemented by additional reasons for “governmental failure” – reasons that more convincingly explain governments’ refusal to provide, or to deliver, all those services their citizens may demand. First, liberal states must often pursue a policy of neutrality between different individuals’ competing conceptions of the good life, requiring a policy of non-intervention in many areas of social life. The state might, for example, have a policy of secularism that precludes it from supporting faith groups. Similarly, much organised political activity – from “party politics” through to single-issue campaigning – must be conducted outside of the state apparatus. To be sure, some states might be prepared to provide some funding to political parties or campaign groups, but still the state stands at arms length to such parties or groups.³⁶ Indeed, in many cases the very point of the organisation in question is to challenge, and attempt to change, the state’s own policies.³⁷ The Citizens’ Advice Bureaux provide but one example of such organisations that are (very largely) funded by, but whose very work requires independence from, the state.³⁸

Second, Weisbrod has noted how governments may lack information about what citizens actually want,³⁹ and how the self-interest of government officials may distort the state’s provision. Frumkin argues that voluntary organisations may be able to identify and respond to social needs more quickly than can government.⁴⁰ And Douglas has suggested a number of “categorical constraints” which attend state provision.⁴¹ Such provision must be fair and equitable, and state officials must be accountable. One manifestation of these “categorical constraints” is the relative uniformity of state provision, compared to the diversity seen in the not-for-profit sector.⁴² In part, this echoes Weisbrod’s argument that the state must adopt a single level of service that is reflective of the median voter, whereas the not-for-profit sector can produce a whole range of differentiated goods, or levels of service, responding to the varying demands of different groups of citizens. Douglas’ point goes further, however, for he notes that sometimes it may be a choice not between *more or less* of some good, but between two very different social policies – to support pro-life, or

³⁵ A Slavinski, “The Public Goods Theory Revisited: Comments on Kingma’s Revisitation of Weisbrod” in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*, at p 68.

³⁶ Relatedly, as Krashinsky has noted, “nonprofit providers provide a layer of insulation between the government and potentially awkward decisions”: M Krashinsky, “Stakeholder Theories of the Nonprofit Sector” in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*, at p 131.

³⁷ This is not to suggest that all groups are equally meritorious simply because they represent an alternative, or a challenge, to the state. Whilst de Tocqueville famously enthused about the contribution of voluntary associations to American democracy (A de Tocqueville, *Democracy in America*, translated and edited by HC Mansfield and D Winthrop, University of Chicago Press, 2000), Hobbes warned of the dangers that voluntary associations might present for the state; T Hobbes, *The Leviathan*, ed CB Macpherson (Penguin, 1977).

³⁸ According to the 2005–6 Annual Report for the Citizens Advice service, the body comprising and supporting the individual CAB, 81.7 per cent of the service’s income was derived from government grants. See <http://www.citizensadvice.org.uk/index/publications/annualreportarchive/annual-report-2006-html-index.htm>.

³⁹ See BA Weisbrod, “Not-for-Profit Organizations as Providers of Collective Goods” in BA Weisbrod (ed) *The Voluntary Nonprofit Sector: An Economic Analysis* (Lexington Books, 1977).

⁴⁰ P Frumkin, *On Being Nonprofit: A Conceptual and Policy Primer* (Harvard University Press, 2002), at p 137.

⁴¹ See J Douglas, Political Theories of Nonprofit Organization in WW Powell (ed), *The Nonprofit Sector: A Research Handbook* (Yale University Press, 1989).

⁴² See T Hayes, *Management, Control and Accountability in Nonprofit/Voluntary Organizations* (Ashgate Publishing, 1996), at pp 24–25.

pro-abortion, policies for example. The state must often speak with a single voice, whereas the not-for-profit sector can reflect society's divergent views.

A further problem suffered by the state lies in its relative inability to experiment. Governments must "adopt the convinced approach of acting on certainties rather than the tentative approach of the experimentalist".⁴³ The voluntary sector, by contrast, is seen as more free to innovate⁴⁴ and to initiate action.⁴⁵ Finally, it is argued, state provision tends to suffer from a greater burden of bureaucracy. The state must be accountable for what it does. It must be able to show that it is treating recipients of its services fairly and equally.⁴⁶ These requirements necessitate that the state's provision be more "formalised", leading in turn to some of the "red tape" for which the state is routinely criticised.

Governance and the "Government Failure" Theory

What implications does the government failure theory have for the governance of not-for-profits? At first sight, the theory would seem to offer a "deregulatory" answer to that question. If the comparative strength of the sector lies in its ability to innovate, and its freedom from the red-tape and the "burdensome requirements" of fairness and accountability that attend state provision, then onerous regulation might do much to undermine these strengths.⁴⁷ A lighter regulatory touch, that defers to the private ordering of participants within not-for-profits, on the other hand, should help to preserve those qualities. The governance regime ought, for example, to work with organisations' own definitions of their objectives or "mission", rather than imposing upon them some competing account of organisational objectives, or some "public benefit" requirement.⁴⁸ Similarly, a deregulatory approach would caution against mandating the internal decision-making structures of not-for-profits. If organisations wish, say, to permit stakeholders a right to participate in the running of the organisation, then they should be free, but certainly not compelled, to do so. Disclosure and accounting obligations should likewise be as light touch as possible. And the courts should be slow to second-guess the decisions of those running such organisations, including in particular their decisions about the distribution of organisational resources amongst potential beneficiaries.

To be sure, this deregulatory approach would still sanction the law playing a facilitative role, providing a legal infrastructure that supports the creation and administration of not-for-profits. "Legal vehicles" – such as specialised forms of company – can be established by the state, which those creating not-for-profits can then easily and cheaply employ as the legal form for their organisation. The UK's recent development of new legal forms for "community interest companies",⁴⁹ and

⁴³ J Douglas, *The Nonprofit Sector: A Research Handbook*, *op cit*, at p 48.

⁴⁴ See also T Hayes, *Management, Control and Accountability in Nonprofit/Voluntary Organizations*, *op cit*, at pp 29–31. Hayes notes, however, that "in some instances, the innovative content [of not-for-profits' outputs] may be of dubious value, especially in cases where the innovation is of the 'pseudo' variety and is, in fact, merely used as a funding device."

⁴⁵ This tendency towards variation in the "internal structure" of not-for-profits seems to gain some empirical support from Leiter's finding of "surprisingly little" "isomorphism" (meaning the tendency towards sameness) among not-for-profits in Australia. See J Leiter, "Structural Isomorphism in Australian Nonprofit Organizations" (2005) 16 *Voluntas* 1–31.

⁴⁶ See P Frumkin, *On Being Nonprofit: A Conceptual and Policy Primer*, *op cit*, at p 77, "[t]here is a fast-growing disjunction between public sector emphasis on accountability and universalism and the sometimes well-defined missions and commitments of many nonprofit organizations" [footnote omitted].

⁴⁷ See eg M Bolton, *The Impact of Regulation on Voluntary Organisations* (NCVO, 2004).

⁴⁸ For a criticism of the rules governing "community interest companies" for their insistence upon "a community benefit" as a precondition for being allowed to use this legal form, see AJ Dunn and CA Riley, "Supporting the Not-for-Profit Sector: The Government's Review of Charitable and Social Enterprise" *op cit*, at pp 651–3.

⁴⁹ See the Companies (Audit, Investigations and Community Enterprise) Act 2004, Part 2.

"charitable incorporated organisations",⁵⁰ perform this task. Similarly, the state can promulgate "default rules" which anticipate the private ordering that participants within not-for-profits would themselves otherwise choose, thereby saving such participants the transaction costs of adopting their own express rules. Nevertheless, a deregulatory approach would urge that such rules remain defaults, capable of exclusion by participants who favour alternative governance arrangements.

Yet there are counter-veiling reasons urging caution in travelling too far down this deregulatory road. For one thing, demonstrating that a lack of bureaucratic regulation has, historically, contributed towards the growth of the not-for-profit sector is a quite different matter from showing, normatively, that such regulation would be unwelcome. Why should we not prefer a smaller, but more regulated, sector? The requirements of fairness and accountability that characterise state provision can plausibly be viewed as positive qualities to which the not-for-profit sector should aspire, rather than downsides to be avoided by a suitably deregulatory regime. And whilst the mere label of *public goods* does not justify treating not-for-profits that supply them as public bodies,⁵¹ we might note again that much provision by the not-for-profit sector is as an agent of the state, delivering goods paid for from the public purse. Moreover, insofar as the not-for-profit is a charity, the subsidies such organisations receive through tax concessions might justify imposing higher standards on such bodies.

Although, then, the governmental failure theory might seem to prescribe a deregulatory governance regime, that prescription is clearly debatable. Moreover, any attempt to press this issue further is hindered by a fundamental limitation of the theory in explaining the role of not-for-profits. The explanation the theory offers is essentially *negative*. It shows why the state does not provide (or deliver) all the public goods or services citizens demand, and thus reveals the vacuum in state provision or delivery that not-for-profits might fill. However, what is clearly also required is a positive theory of why not-for-profits are able to fulfil (at least some of) this unmet demand. Such a theory must explain not merely why there is a demand for the non-state provision (or delivery) of public goods, but also why this demand is for specifically not-for-profit, as *opposed to for-profit*, supply (or delivery). As James and Rose-Ackerman have noted, "[t]he Weisbrod model explains why private provision of public goods may exist. However, it does not explain why this private production is nonprofit."⁵²

It is perhaps tempting to think that the answer lies in the lack of the beneficiaries' resources: recipients of, say, famine relief can hardly afford to purchase such relief from a for-profit provider. Yet not-for-profits must still acquire all the inputs necessary to make such provision. If they are able to secure volunteer labour, donations from supporters, and the like, to cover these costs, the question remains why not-for-profits are better able than are for-profits to acquire such inputs. Similarly, it is not enough to show that government in the UK (as elsewhere) is increasingly keen to use the private sector to deliver state-funded services; that begs the questions of when, and why, it chooses to delegate such delivery to the not-for-profit, rather than to the for-profit, sector?

Finally, the importance of showing when (and why) not-for-profits are preferred to for-profits is particularly necessary given that much not-for-profit activity is in fact concerned with the supply of essentially private goods. From large universities to small

⁵⁰ See the Charities Act 2006, Part 2, Chapter 8.

⁵¹ The concept of "public goods" is an economic one, and it seems doubtful that that necessarily requires those who supply such goods to be under "public body" like obligations.

⁵² E James and S Rose-Ackerman, *The Nonprofit Enterprise in Market Economics* (Harwood Academic Publishers GmbH, 1986) 28.

"charity-shops" and church tea-rooms, much of the sector is supplying goods that are neither non-rival nor non-excludable. In many such areas, not-for-profits compete alongside for-profit businesses, a position that is likely to increase with moves towards greater "commercialism" by not-for-profits and the growing emphasis upon "social enterprise".⁵³ What has now become the orthodox explanation for the boundary between the for-profit and the not-for-profit sector is provided by the second theory we shall address, and to that we now turn.

ASYMMETRIC INFORMATION AND THE VALUE OF TRUST

This theory has its origins⁵⁴ in research preceding that of Weisbrod,⁵⁵ but its full (and most general) statement appeared first in the seminal work of Hansmann, at the beginning of the 1980s.⁵⁶ Hansmann's analysis, like Weisbrod's, starts with a problem of market failure. However, his concern is not to show, negatively, why government *also* fails.⁵⁷ Instead, he wants to show, more positively, why not-for-profits can offer a solution to the specific instance of market failure that he identifies.⁵⁸

That failure is one of "asymmetric information" – the situation where one party to a deal knows less than the other. If a consumer cannot determine whether the product she is being offered is a good one or a "lemon",⁵⁹ then there is a risk that her ignorance will be exploited by a supplier that is intent upon maximising its profits. The same analysis can be applied where a donor gives money to purchase a good or service for another: shelter for the homeless, relief to overseas famine victims, and so on. Such a donor often has no – or at least no practical – way of discovering whether her donation is ever actually used in the way she expected.

The not-for-profit form, it is argued, provides a safeguard for donors and consumers against the exploitation of their ignorance. This safeguard is achieved by the non-distribution constraint (or "asset lock") to which not-for-profits are subject. Profits must be retained within the organisation. This constraint reduces the incentive to exploit consumers' or donors' ignorance, providing an important reassurance to them, and making them readier to trust not-for-profits. It is this enhanced trust enjoyed by not-for-profits in the face of significant informational asymmetry that can give them an advantage over for-profits, and explains why (and when) not-for-profits flourish and survive even when in competition with for-profits.

The literature has noted a number of situations in which the problem of informational asymmetry is likely to be particularly severe. Contracting for the future

⁵³ The promotion of social enterprise within the UK now falls within the remit of the Office of the Third Sector; see http://www.cabinetoffice.gov.uk/third_sector/social_enterprise. For some of the theoretical issues raised by this move towards greater commercialism, see BA Weisbrod (ed) *To Profit or Not to Profit: The Commercial Transformation of the Nonprofit Sector* (Cambridge University Press, 1998).

⁵⁴ For the history behind Hansmann's work, and his contribution to theorising not-for-profits, see PD Hall, "A Historian's Perspective" (1999) 28 NVSQ 213.

⁵⁵ See eg KJ Arrow, "Uncertainty and the Welfare Economics of Medical Care" (1963) 53 *The American Econ Rev* 941–73.

⁵⁶ See especially HB Hansmann, "The Role of Nonprofit Enterprise" *op cit*.

⁵⁷ In explaining the general tendency of economists to ignore the choice between nonprofit and governmental enterprise, Hansmann has noted "the fact that contemporary economic theory offers a much more coherent view of the role of for-profit enterprise than it does of the role of governmental enterprise..." See HB Hansmann, "Economic Theories of Nonprofit Organization" in WW Powell (ed), *The Nonprofit Sector: A Research Handbook* (Yale University Press, 1989), at p 34.

⁵⁸ This explanatory framework is not limited to business firms, but can be extended to a much broader range of organisations. So, in HB Hansmann, *The Ownership of Enterprise* (Harvard University Press, 1996) Hansmann generalises this theory to explain a range of different types of firm as responses to different forms of market failure.

⁵⁹ The terminology comes from GA Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism" (1970) 84 *Quarterly J of Economics* 488–500.

supply of services, for example, will often be more problematic than buying mass-produced goods,⁶⁰ whilst informational asymmetry also increases as the complexity of the service increases. Someone purchasing, say, medical or dental treatment largely relies on the provider to determine just what treatment is appropriate, and judging whether the service contracted for was actually delivered is similarly difficult. These problems are exacerbated where the consumer is buying something for a third party (explaining the prevalence of “donative” not-for-profits).⁶¹ In such cases the consumer may have no easily available information about whether the contract was actually fulfilled. Take again the example of a donor who wishes to contribute towards the relief of poverty overseas. Even if she were able to specify exactly what is being bought by her donation,⁶² still the fact that the item is being provided for another (geographically distant) person makes it difficult for her to ascertain whether this good or service is in fact delivered. Even if the donor were able to ascertain whether the organisation to which she donated has been making *some* provision, still it is unlikely she can determine whether *her own* contribution was actually spent in that way, or was merely siphoned off into someone else’s pocket.

Of course, asymmetrical information is ubiquitous. This might be seen to challenge the descriptive accuracy of Hansmann’s account, for we might then wonder why there remain so many *for*-profits. However, not every instance of information asymmetry is likely to lead consumers to choose to deal with a not-for-profit.⁶³ If the parties are “repeat players”, then even for-profit organisations will balance the benefits gained by exploiting their private information against the loss of future business from this consumer. If for-profits care about their reputations, they have a (entirely self-interested) reason sometimes to act in trustworthy ways. Further, the law often does much to protect consumers against opportunism. It might impose mandatory obligations on better-informed parties, such as requirements to supply goods of reasonable quality, to carry out work with reasonable care and skill, and so on. Even if the rules are merely excludable defaults, attempts by better-informed parties to exclude them can alert the consumer to the fact that she may be being sold a lemon.⁶⁴ Licensing regimes can be used to weed out some traders who are untrustworthy (and to provide a threat to those that remain).⁶⁵ And technological developments, such as the explosion in information that the internet has facilitated, can reduce the costs to consumers of becoming better informed.

Governance in the Face of Asymmetric Information

The theory clearly adds much to our understanding of the role of not-for-profits. The problem of informational asymmetry is a well-recognised phenomenon in both economic and legal literature, and it is plausible to think that not-for-profits can help

⁶⁰ A Bacchiega and C Borzaga, “The Economics of the Third Sector” in HK Anheier and A Ben-Ner (eds) *The Study of Nonprofit Enterprise: Theories and Approaches*, *op cit*, at p 29.

⁶¹ The term is Hansmann’s, and refers to those not-for-profits that are funded through donations, rather than by selling their goods or services to consumers.

⁶² This will often be most unlikely. Transaction costs make it expensive for her to do so, and in any case donors may think that the recipient organisation, armed with fuller information about local needs, will better judge how her donation can best be used. To be sure, many charitable organisations “sell” specified benefits which donors can buy for the charity’s beneficiaries (see, for example, the “Oxfam Unwrapped” campaign: <http://www.oxfamunwrapped.com/WhereYourGiftsGo.aspx>). In fact, many of these schemes allow for the charity to use the donation to purchase the named item or a related one.

⁶³ Car repairs, central heating servicing and dental work are three obvious examples of work that is highly technical yet for which we predominantly employ for-profit businesses.

⁶⁴ For a brief discussion of some of the issues raised by these so-called “penalty defaults”, see CA Riley, “Designing Default Rules in Contract Law: Consent, Conventionalism, and Efficiency” (2000) 20 OJLS 367.

⁶⁵ See, for example, the licensing regime under the Consumer Credit Act 1974 that requires those who provide consumer credit to be licensed by the Office of Fair Trading.

to alleviate its risks. There seems some correlation between those situations where information asymmetry is likely most severe – especially where donors fund the consumption of others – and those situations where not-for-profits flourish. Furthermore, the theory provides a powerful counter-argument against (at least some of) the deregulatory implications of the “government failure” theory discussed above. The task is not merely to make not-for-profits look attractive compared to the state, but also compared to for-profits. Given that, the case for regulation that will ensure the trust of those dealing with not-for-profits becomes much more compelling.

It is strongly arguable, however, that Hansmann places too much emphasis upon the non-distribution constraint as the governance mechanism which builds such trust, an over-emphasis that is necessitated by the very way he constructs the enquiry he is undertaking. For Hansmann, it is the non-distribution constraint that defines the not-for-profit organisation.⁶⁶ His enquiry is precisely why organisations, defined by reference to that constraint, survive. Since he wants to explain the survival of firms with a non-distribution constraint, he necessarily must take that constraint as being decisive to their survival. As he writes, “I have stressed the nondistribution constraint as the essential characteristic that permits nonprofit organizations to serve effectively as a response to contract failure.”⁶⁷

Given that, however, it is surprising to find Hansmann rather equivocal about the actual effectiveness of that legal constraint (at least in the United States). He observes that enforcement lies in the hands of each state’s attorney general, yet few resources are committed to that task.⁶⁸ As a result “with such limited policing, it is not surprising that the managers of many nonprofit organizations succeed, to a greater or lesser extent, in evading the nondistribution constraint and in enriching themselves at the expense of the organizations and their patrons.”⁶⁹ Not-for-profits can become, as it has been put, “for-profits in disguise”.⁷⁰

It might be counter-argued that things are rather different in the UK. For charities, the reasonably strong regulatory functions performed by the Charity Commission⁷¹ do much more to ensure a proper lock on assets.⁷² Likewise, one of the reasons for the government’s introduction of a new legal vehicle – the Community Interest Company (“CIC”) – for non-charitable not-for-profits was the need to provide an effective asset lock for such enterprises. And the statutory scheme for such companies suggests that that lock will indeed likely be more effective.⁷³ There is, for example, a statutory cap on distributions,⁷⁴ supplemented by detailed regulations specifying permitted distributions,⁷⁵ and overseen by the “Regulator of Community Interest Companies”.

However, this counter-argument is unconvincing, and for two reasons. First, although a sizeable number of CICs have already been formed,⁷⁶ it would be premature to conclude that the CIC is largely replacing alternative vehicles for non-charitable

⁶⁶ See HB Hansmann, “The Role of Nonprofit Enterprise” *op cit*, at p 838.

⁶⁷ HB Hansmann, “The Role of Nonprofit Enterprise” *op cit*, at p 873.

⁶⁸ He acknowledges that the Internal Revenue Service might take an interest in breaches of the constraint, but even there suggests it has “not been particularly zealous”; *ibid*, at p 874.

⁶⁹ HB Hansmann, “The Role of Nonprofit Enterprise” *op cit*, at p 874.

⁷⁰ See eg R Steinberg and BH Gray, “The Role of Nonprofit Enterprise” (1993) 22 NVSQ 297.

⁷¹ The Charity Commission deals with charities in England and Wales, but a similar observation applies for those that are registered in the Scottish Charity Register, given the oversight of the Office of the Scottish Charity Register.

⁷² See generally P Luxton, *The Law of Charities* (Oxford University Press, 2001) ch 10.

⁷³ Given the very recent introduction of this legal form, any prediction of its likely effectiveness must be speculative.

⁷⁴ See Companies (Audit, Investigations and Community Enterprise) Act 2004, s 30.

⁷⁵ The Community Interest Company Regulations 2005, SI 2005/1788.

⁷⁶ The website of the Regulator of Community Interest Companies lists a population of 779 CICs as at the 5 March 2007; see <http://www.cicregulator.gov.uk/coSearch/companyList.shtml>.

not-for-profits which lack this effective lock on assets. Many "ordinary" not-for-profit guarantee companies⁷⁷ (which lack an effective lock on assets⁷⁸) remain. We would require more evidence that such companies are failing to attract the trust of their donors or consumers before trumpeting the importance of the non-distribution constraint to the success of not-for-profits. Second, the very fact that, in the US, a flourishing not-for-profit sector exists *notwithstanding* the absence of a really effective lock on assets must cast doubt on whether the presence of such a lock in the UK has much impact on the success of the sector here.

This is not to suggest that an effective lock on the assets of not-for-profits is normatively insignificant or undesirable, only that such a lock may be less important than Hansmann suggests in *explaining* the survival of not-for-profits. Moreover, if that is correct, then the governance regime for not-for-profits must look beyond a lock on assets to a variety of additional measures necessary to secure effective trust by those dealing with not-for-profits. To that point we return below. Before doing so, however, we address a more fundamental challenge to Hansmann's analysis of not-for-profits, namely that it fails to reflect the extent to which not-for-profits can be regarded as "participatory communities", in which participation is an end in itself, or is a means of discovering and expressing the values of participants.

NOT-FOR-PROFITS AS PARTICIPATORY COMMUNITIES

Both the theories considered above adopt an "instrumental" view of the role of not-for-profits. They are explained as responding to instrumentally-rational calculations by those who deal with, and thus sustain, such organisations. Those who want, say, more public goods than the state is willing to provide, or who wish to donate to others but appreciate their own comparative ignorance, calculate⁷⁹ that sometimes they will better fulfil their preferences by dealing with not-for-profits. Such reliance on instrumental rationality to explain the behaviour of economic agents is hardly surprising, for instrumental rationality is central to (mainstream) economic analysis.⁸⁰ It has the obvious advantage of "parsimony", for it allows simple yet elegant explanations of economic phenomena to be produced. These do not need to account for, say, some individuals' desire for more public goods than the "average citizen", or their wish to spend their money improving the lives of others. Such preferences can simply be taken as given and, moreover, as arising "exogenously" in the sense of outside of the institutions (in this case, not-for-profits) that are being explained. Such preferences cause, but are not caused by, those institutions.

Although instrumental rationality surely explains some behaviour by those involved with not-for-profits, it also misses two significant, and inter-connected, aspects of such behaviour. These are, first, the value to many stakeholders of *participating* within the organisation and, second, the *expressive* aspects of such participants' relationships. We shall say more in a moment to justify this emphasis upon participation, but first we need to clarify the sense in which participation is being employed here. The term is

⁷⁷ *I.e.*, guarantee companies that are *not* CICs, since the latter can also be formed as a species of guarantee company.

⁷⁸ For such companies, the lock on assets will be "self-imposed" (typically through a provision in the company's own constitution). Enforcement of such a provision suffers from a number of legal difficulties. Only members of the company (as opposed to, say, a customer or donor) have *locus standi* to enforce such constitutional provisions, whilst actions brought against the company's directors for breaching their duties (say by acting for an improper purpose) would need to be actions by the company itself (or, exceptionally, as derivative actions).

⁷⁹ Or at least they act *as if* they calculated.

⁸⁰ See S Hargreaves Heap, M Hollis, B Lyons, R Sugden and A Weale, *The Theory of Choice* (Blackwell Publishers, 1992) ch 1.

being used to mean any close involvement in the life of the organisation. It would include taking part in company decision-making (through whatever organ of the company), but would extend beyond this to, say, a personal relationship between a donor and a not-for-profit under which the former makes repeated gifts to the latter.⁸¹ Of course, participation defined in this way is not unique to not-for-profits. Employees of for-profits clearly participate within such organisations, as do their investors and sometimes their suppliers and consumers too. The claim here is only comparative. On average, participation is, it is being argued, more significant to those who say, donate to, or consume the output of, not-for-profits than it is for those who consume the goods or services of for-profits. And the same for those who work for not-for-profits compared to those who work for for-profits. And so on. Similarly, it is also clear that the importance of participation will vary a good deal amongst the different stakeholders of a not-for-profit (or indeed between different not-for-profits). Many a donor may seek no close relationship with an organisation to which she gives money. Many consumers may be perfectly happy to conduct their relationship with a not-for-profit entirely at arms-length.

The value of participation to stakeholders can arise in a number of ways. First, there are what might be termed “in process” benefits from a feeling of belonging within a community, from being part of a team that is working collectively towards some goal, the value of which matters deeply to the participant. Therapeutic self-help groups and faith-based communities provide somewhat extreme examples of this phenomenon, but more worldly examples abound. In an age when political democracy can seem increasingly impersonal or impoverished, other communities are sought for opportunities to debate one’s visions and to formulate, defend and pursue concrete actions for change.⁸² To be sure, such participation may have an eye to the eventual destination to which it is hoped to steer the organisation, but the journey itself may be just as significant to participants.

The second source of benefits from participation takes us into the “expressive” aspects of some stakeholders’ relationships. This builds, in turn, on the notion of “expressive rationality” to explain some economic behaviour. The idea is that some action is not so much aimed at securing an objective that the agent already has (say to secure some decent service for herself in the face of her ignorance, or to give help to others), but rather is part of what Hargreaves Heap has called “the project of making sense of the self”.⁸³ There are several different elements to this. Partly, it suggests that some of our economic decisions are about expressing the values we hold dear. When we buy red noses, for example, or choose not to send our children to private schools (a decision, in a sense, *not* to be a consumer), we are also⁸⁴ making public statements about the values we cherish, and thus the sort of people we are. The not-for-profit sector can then be explained as enabling people to fulfil this expressive need. As Frumkin has argued,

the [not-for-profit] sector can be seen as valuable because it allows individuals to express their values and commitment through work, volunteer activities, and donations. By committing to broad causes that are close to the heart or by giving to an effort that speaks

⁸¹ Thus, in *explaining* the not-for-profit, participation is deliberately not being tied to a taking part in *governance*. For our later purpose of prescribing the governance regime of a not-for-profit, however, such a linkage must be made.

⁸² For an argument on the necessity of participation to the reinvigoration of civil society, see K Thomson, *From Neighborhood to Nation: The Democratic Foundations of Civil Society* (University Press of New England, 2001).

⁸³ See S Hargreaves Heap, M Hollis, B Lyons, R Sugden and A Weale, *The Theory of Choice*, *op cit*, at p 22.

⁸⁴ This is not to deny that part – and sometimes the dominant part – of our motive may be the desire to achieve the objective that this cause pursues.

directly to the needs of the community, nonprofit and voluntary action answers a powerful expressive urge.⁸⁵

Of course, this “expressive need” can sometimes have self-interest at the helm. We may wish to make a public statement about the kind of people we are – generous, caring, charitable – in order, as Posner notes,⁸⁶ to enjoy an enhanced status and the better opinion of others.⁸⁷ The point here concerns only the existence – and not necessarily the virtue – of this expressive motive.

There are, moreover, two other elements to this idea of “making sense of the self” that go beyond just expressing one’s currently held values. First, sometimes we simply are not sure what our values are. Some of our behaviour is exploratory: trying to work out what we think is right and wrong, and not merely what will give us the best “payoffs” in satisfying our existing preferences. Volunteering to work with asylum seekers, for example, may be partly about trying to work out just where we really stand on the range of issues that phenomenon raises. Secondly, sometimes we know the sort of person we want to be, and yet we also know that we do not yet “think” like that; have not yet really internalised the values we wish we held. Participation in organisations can be a means of making ourselves think and be like the persons we wish we were.⁸⁸ We join, say, environmental pressure groups not just because we want to make the world a greener place, nor just to tell the world how green we are, but sometimes also because we know we are actually less green than we would like to be.⁸⁹ This also undermines the idea, noted above, that our preferences arise “exogenously”. Participation in not-for-profits will sometimes be the cause, and not merely the consequence, of our preferences.

A final benefit of participation accrues primarily to those stakeholders who will consume the outputs of the not-for-profit. For them, participation also provides a mechanism for communicating their preferences to the organisation, and being involved in the design and the delivery of the goods or services they will consume. It can thus empower them in a way that being a mere contractor in the market, or a passive recipient of state welfare policies, may well fail to do.⁹⁰

We have stressed then, these twin aspects – of participation and expressive rationality – of the relationships between stakeholders and not-for-profits. There are, as we have seen, inter-connections between them, but each might operate alone. We can sometimes express our values even whilst remaining as arms-length consumers. There is, for example, currently a profusion of wrist-bands, ribbons and other accessories which one can purchase and wear to express one’s support for a variety of causes. Those who do so may be expressing their values, but they frequently participate little in the organisation which sells them. And we may participate in organisations sometimes for very instrumental reasons; say, as noted already, just to ensure the good or service we receive is to our liking. But much expressive activity is pursued by participation, and much participation is expressive in character.⁹¹

⁸⁵ P Frumkin, *On Being Nonprofit: A Conceptual and Policy Primer*, *op cit*, at p 23.

⁸⁶ EA Posner, “Altruism, Status, and Trust in the Law of Gifts and Gratuitous Promises” (1997) *Wisconsin L. Rev* 567, at pp 572–7.

⁸⁷ Such “social” esteem might, of course, have economic consequences, as where businesses are favoured because of their reputation as contributors to good causes.

⁸⁸ The idea might be expressed in Frankfurt’s terminology of “second order desires”; we have the capacity (unless we are what Frankfurt terms “wantons”) to reflect on our first order desires, and to select the first order desires we wish we held; H Frankfurt, “Freedom of the will and the concept of a person” (1971) 68 *J of Philosophy* 5.

⁸⁹ The point does not only apply to membership of not-for-profits, as seems to be shown by the rush to join (for-profit) gyms in the (apparently often failed) hope that it will foster a desire for exercise.

⁹⁰ See S Elstub, “Towards an Inclusive Social Policy in the UK: The Need for Democratic Deliberation in Voluntary and Community Associations” (2006) 17 *Voluntas* 17.

⁹¹ This need not, of course, be legal membership of the organisation.

One consequence of this emphasis upon participation and expressive rationality in the context of not-for-profits is that such organisations no longer appear quite such a residuary phenomenon, merely picking up the slack from market- or government-failure. We may support not-for-profits even when we think that a for-profit might, say, deliver more of our donations in aid to the cause we support. We might wish to express our commitment to the values that organisation supports, and to disavow the idea that any organisation should make a profit out of human suffering. Acknowledging the participatory and expressive roles of not-for-profits also suggests a different emphasis in thinking about why we trust not-for-profits. Rather than seeing such trust as a response to a constraint on distributions, trust may flow from one's own participation, from one's identification with the values of the organisation, and one's personal relationship with those who lead it.

Finally, note how the participatory nature of not-for-profits also offers a different explanation for why they are sometimes chosen for the delivery of state-funded services, in preference to delivery by the state itself, or by for-profits. "Informational asymmetry", for example, looks a poor explanation for why the state chooses not-for-profits, rather than for-profits, for the delivery of state-funded services. The fact that an organisation is precluded from distributing profits may provide some reassurance to the state about the quality of service it is buying. However, given the power of the state as a contracting party, together with the likely size of the contract and the fact that the parties will be "repeat players", one suspects that informational asymmetries are much less severe than where, say, an individual makes a one-off, small donation to a good cause. Rather, the state may deliver goods or services through not-for-profits because it genuinely wishes to support the values of the sector (and perhaps because politically it softens the move towards the privatisation of state provision). Moreover, for some commentators, a clear strength of the not-for-profit sector lies in the moral commitments of its participants, commitments that can in turn energise volunteers, donors, and social entrepreneurs and "add value" to the services they deliver.⁹² Such commitments can perhaps be seen most clearly in the case of faith-based organisations, and also underpin attacks on welfare state policies that may deliver services but also lead to dependency.⁹³ However, similar views also find support in (secular) communitarian thinking, which praises not-for-profits for promoting a "self-help" approach to social problems, and for giving a sense of empowerment and autonomy to both participants within not-for-profits themselves, and to the broader society in which not-for-profits function.⁹⁴

The Supply of Not-for-Profits

We have, so far, concentrated upon the importance of participation and expressive rationality to those stakeholders who deal with an organisation *once formed*. However, these concepts are relevant also in understanding the supply of not-for-profits in the first place. It is obvious (yet still helpful) to observe that not-for-profits must be formed by those who desire their existence sufficiently to be troubled to create them. As Ben-Ner and Hoomissen noted, not-for-profits should be regarded "*at their inception*, as coalitions of individuals who associate to provide themselves and others with goods or services that are not adequately supplied by either for-profit or government organizations."⁹⁵ Whilst acknowledging the "mutual" nature of not-for-profit creation,

⁹² See P Frumkin, *On Being Nonprofit: A Conceptual and Policy Primer*, *op cit*, ch 4.

⁹³ See DG Green, *Reinventing Civil Society* (Institute of Economic Affairs, 1993);

⁹⁴ See eg H Tam, *Communitarianism* (New York University Press, 1998) especially ch 8.

⁹⁵ A Ben-Ner and T Van Hoomissen, "Nonprofit Organizations in the Mixed Economy" in A Ben-Ner and B Gui (eds) *The Nonprofit Sector in the Mixed Economy*, *op cit*, at p 29, emphasis in original.

however, it is also important to stress that the process will often be led by "social entrepreneurs". Such social entrepreneurs may, for example, be future consumers who take the initiative in encouraging others to organise themselves: a parent, for example, who rallies other parents to join her in forming an after-school club, a nursery, or whatever. Or they may be individuals or groups who recognise some unmet demand from others and take the lead in creating an organisation to meet it.

The question of what characteristics make a social entrepreneur has received a good deal of attention. Young, for example, has sought to identify different *types* of social entrepreneur who may instigate the formation of not-for-profits, and then to relate those types to the subsequent behaviour of not-for-profits themselves.⁹⁶ However, their *motives* for forming a not-for-profit are likely to reflect those discussed already in relation to other stakeholders. Sometimes the motive will be instrumental – better to ensure the availability of the goods or services to be produced by the not-for-profit. Other times the motive will include the possibility of future participation in the life of the not-for-profit, and the wish to express, explore or internalise the entrepreneur's values.⁹⁷

We might pause here to note a rather different emphasis in explaining the creation of not-for-profits. Ben-Ner (and his co-authors) have argued that what motivates some future participants to bother to create a not-for-profit (rather than merely, say, waiting for someone else to do so), is the *control* they will subsequently enjoy by so doing: "[a] nonprofit organization will be formed only if a group of interested stakeholders (individuals or organizations) has the ability to exercise control over the organization".⁹⁸ "Control" here seems to mean "effective" or "practical"⁹⁹ control: the power of "determining a firm's objectives and inducing management and employees to pursue these objectives".¹⁰⁰

There is clearly some connection between this emphasis on control, and the importance attached in this article to "participation". For Ben-Ner, the prospect of the passive protection afforded by, say, the non-distribution constraint is insufficient to explain the creation of not-for-profits. Rather, creators want control, and since that control is to be "direct", participation within the organisation seems an essential part of achieving that. However, there are good reasons for placing some distance between the participatory element of not-for-profits, and the "control account" of not-for-profits advanced by Ben-Ner. For one thing, in the control account, control itself is seen in *instrumental* terms. Those forming, or sustaining, not-for-profits are motivated by the control they will enjoy, and that control is desirable because it ensures the organisation will act in ways desirable to them – to deliver the goods or services they want, at the right price, or of the right quality. Participation is *not* seen as desirable in its own right – as an end in itself. This ignores the fact that stakeholders may participate in not-for-profits not to achieve control, but because they find it rewarding to have an area of life in which they have the chance to speak, and in which they can share and defend ideas for change. Likewise, participation as an exercise in expressing, discovering or internalising the values that stakeholders hold dear is similarly left out

⁹⁶ See D Young, *Entrepreneurship and the behavior of nonprofit organization: Elements of a theory* (Yale University PONPO Working Paper No 4, 1980)

⁹⁷ See also S Rose-Ackerman, "Altruism, Ideological Entrepreneurs and the Non-profit Firm" (1997) 8 *Voluntas* 120.

⁹⁸ A Ben-Ner and T Van Hoomissen, "Nonprofit Organizations in the Mixed Economy" in A Ben-ner and B Gui (eds) *The Nonprofit Sector in the Mixed Economy*, *op cit*, at p 52.

⁹⁹ The difference between "*de facto*" and "*de jure*" control has found judicial recognition in the jurisprudence on the derivative action in English company law; see *Prudential Assurance Co Ltd v Newman Industries Ltd* [1980] 2 All ER 841.

¹⁰⁰ A Ben-Ner, "Who Benefits from the Nonprofit Sector?" (1994) 104 *Yale LJ* 731, at p 754.

of this instrumental view of control. Second, the emphasis placed upon control suggests a benign view of the power relations within not-for-profits. There are, it will be argued below, real problems in converting participation into control, and whilst steps to secure greater control by participants is one strategy the governance regime might adopt, it would not be wise to place too many eggs in that particular basket.

THE GOVERNANCE OF NOT-FOR-PROFITS AS PARTICIPATORY COMMUNITIES

If not-for-profits are indeed to be understood as participatory communities, then what governance implications follow? To repeat the caveat in the introduction to this article, the aim here is to suggest in outline some of these implications, but not to offer a full and detailed governance prescription for not-for-profits. Note also that the account of not-for-profits as "participatory communities" has developed incrementally. In particular, it has sought to build upon, rather than in any sense replace, the two leading, prior theories of not-for-profits: those based upon government failure, and upon informational asymmetries. Those prior theories continue to offer important implications for the governance regime for not-for-profits. Take first the government failure theory. As noted above, that account of not-for-profits is essentially negative, showing why the state does not provide (or deliver) all the public goods or services citizens demand. Nevertheless, it provides a necessary and important reminder that the governance regime must facilitate the sector to step in where the state cannot or does not work. Moreover, it must also take some care not to overburden the sector with regulation that will negate the very reasons why the sector is sometimes, quite appropriately, preferred to the state. However, as we noted earlier these are not "knock down" arguments in favour of a wholly deregulatory approach, and counter-veiling concerns about the importance of fairness and accountability, as well as the responsibilities that follow from the receipt of public funds, can justify necessary regulation. This may not, of course, always require legal regulation. Codes of practice may sometimes offer a better compromise between the need to raise standards and the need to avoid overburdening organisations with expensive and inflexible regulation.¹⁰¹

Building Trust and Fiduciary Obligations

Similarly, the asymmetrical information account of governance rightly emphasises the importance of trust to the survival of not-for-profits, and therefore the importance of a set of regulatory mechanisms designed to ensure trustworthy behaviour by those who control such organisations. These must include a "lock" on organisational assets. We noted above, however, concerns about the effectiveness of this constraint. Moreover, there are at least two other good reasons why such a lock is likely to make a modest contribution to the governance of not-for-profits. First, it is essentially negative. It says something of what a not-for-profit may *not* do with its resources but does not tell us, positively, what it *must* do.¹⁰² Yet those dealing with a not-for-profit are surely concerned to ensure that its mission is effectively pursued, not merely that money is *not* spent in *undesired* ways. Most donors to Oxfam, for example, surely want to know Oxfam spends their money in "overcoming poverty and suffering", rather than merely

¹⁰¹ See for example the ICSA/NCVO draft *Code of Governance* op cit n 8; Home Office, *Compact on Relations Between Government and the Voluntary and Community Sector in England* (Home Office 1998).

¹⁰² A Ben-Ner and B Gui, "The Theory of Nonprofit Organizations Revisited" in HK Anheier and A Ben-Ner (eds), *The Study of Nonprofit Enterprise: Theories and Approaches*, op cit, at p 7.

that it refrains from inappropriately distributing their donations. Second, as many have noted, not-for-profits do suffer from disadvantages of their own compared to for-profits. The absence of the profit motive can dull the incentives on their managers to run the organisation efficiently. They also have, it is argued, a tendency to over-longevity; they are "cushioned" against downturns in demand for their goods or services, and therefore slower to terminate uneconomic operations.¹⁰³ Those are problems the non-distribution constraint hardly addresses.

Beyond the lock on assets, trustworthiness by those running not-for-profits can also be addressed through the imposition of legal duties upon their directors. In addition to a legal duty to act with a necessary level of competence (or "care and skill"), fiduciary duties can also demand loyalty to the interests of the organisation through the imposition of obligations to account for secret profits, to exercise powers for proper purposes, to avoid conflicts of interest and to promote the success of the organisation.¹⁰⁴ All this is quite familiar from the regulation of for-profit companies. In the context of not-for-profits, however, the formulation or application of these duties must respond to two sources of complexity. First, suppose that we assumed that not-for-profits had *only* an instrumental role, satisfying the demands of their beneficiaries (and, through the latter, of the organisation's donors). Nevertheless, directors would still need to choose between different policies that would treat, say, current beneficiaries differently *inter se* (to subsidise some outputs at the expense of others), or that would treat, say, current and future beneficiaries differently (to provide more for less cost now, or to reduce expenditure now in order to provide more or better services later). The fiduciary duty upon directors to act in the best interests of the organisation must extend to an obligation to show that beneficiaries have been treated fairly *inter-se*.

The second source of complexity arises because of the tension between the instrumental and the expressive roles of not-for-profits. Frumkin has made the point that the trend towards demanding greater "professionalism" of those running not-for-profits poses a threat to the eclecticism of the sector, and the private values and commitments of its participants.¹⁰⁵ The rise of "professionalism" can itself be seen as, in part at least, a product of the increased emphasis upon accountability, upon high standards of corporate governance, and upon the rational pursuit of organisational (instrumental) goals. The point here is that the board must strike a fine balance between pursuing such professionalism, yet taking care not to lose the eclecticism and expressive aspects of not-for-profits.¹⁰⁶ And the review of directors' behaviour for alleged breaches of duty must be sensitive to this balancing exercise (in a way that is unnecessary for for-profits).¹⁰⁷

¹⁰³ HB Hansmann, "Economic Theories of Organization" in WW Powell (ed), *The Nonprofit Sector: A Research Handbook* (Yale University Press, 1989), at p 38.

¹⁰⁴ A good deal of the literature in the USA has addressed the question whether the duties on not-for-profit directors should be the same as, or more, or less, demanding than the corresponding duties on directors of for-profit companies; see for example HJ Goldschmid, "The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems and Proposed Reforms" (1997-8) 23 *J of Corp Law* 631; JJ Fishman, "Standards of Conduct for Directors of Nonprofit Corporations" (1987) 7 *Pace L Rev* 389.

¹⁰⁵ P Frumkin, *On Being Nonprofit: A Conceptual and Policy Primer*, *op cit*, at pp 100-4.

¹⁰⁶ Since it is the duty of care and skill to which directors are subject that speaks most directly to this issue, there may be some cause for concern that that duty has taken an increasingly objective turn. See for example *Norman v Theodore Goddard (a firm)* [1992] BCLC 1028; *Re D'Jan of London Ltd*; *Copp v D'Jan* [1994] 1 BCLC 561. This objective standard has now been codified in Companies Act 2006, s 174. For arguments against such a move (albeit in the context of for-profit companies) see CA Riley, "The Director's Duty of Care and Skill: The Case For an Onerous But Subjective Standard" (1999) MLR 697.

¹⁰⁷ This is so notwithstanding the move towards so-called "enlightened shareholder value" in the statutory definition of the director's duty to promote the success of the company in the Companies Act 2006, s 172. It seems clear that directors are to have regard only instrumentally to the various interests and "stakeholders" set out in ss 172(1)(a)-(e), insofar as doing so will work "for the benefit of the members as a whole".

Such sensitivity must also be practised by whatever "external" regulatory agency is charged with the oversight of not-for-profits. The need for such an agency follows in part from the inevitable limitations in both the non-distribution constraint itself, and other mechanisms such as the imposition of fiduciary duties. Further, failures within any particular not-for-profit impact not only upon the beneficiaries of that particular organisation. Rather, they can undermine the not-for-profit "brand",¹⁰⁸ justifying action to maintain confidence in the sector as a whole. Finally, the need for an external regulator also reflects the fact that for at least some not-for-profits (those that are charities) the public subsidises their activities through tax concessions, and has a legitimate interest in ensuring some public benefit in return. However, as important as such a regulatory function may be, still its review of directorial conduct must take account of the different roles that not-for-profits play, and which directors can legitimately balance.

Stakeholder Democracy

We noted before how participation can take a variety of forms, and might, but need not, involve taking part in internal decision-making. Here, however, we move to consider that issue, being perhaps the one where the participatory nature of not-for-profits has the greatest significance. Of course, democratic participation itself remains a fairly broad concept, the conditions for which might be expressed in more or less demanding ways,¹⁰⁹ and to achieve which a variety of institutional arrangements are feasible.

One such arrangement is through the (legal) status of membership of the organisation. The very category of member is admittedly a difficult one. In for-profits, its equivalent – the shareholder – corresponds to a clear economic relationship. In not-for-profits, however, this is not the case. Rather, membership is an *additional status* that can be made available to other stakeholder relationships, such as donor, consumer, beneficiary, employee, supplier and so on. The rights and duties attaching to the category of member can, then, be fashioned by law to facilitate membership and achieve a role that supports the proper function of not-for-profits and, more specifically, that provides a vehicle through which those stakeholders who wish to participate within the organisation are able to do so.

If participation is to be effective, however, the governance regime must strive to make member-democracy a rather less hollow slogan than is too often the case in for-profit companies. The regime must make membership easy to acquire (and give up).¹¹⁰ Member participation requires rights to attend, and to vote, at member meetings, but surely much else besides. Full information is a pre-requisite for meaningful engagement with the organisation. Although an important part of this disclosure must relate to the financial health of the not-for-profit, it is clear that it cannot cover only that. Disclosure must reflect both the instrumental and expressive roles or, as it is sometimes said, these multiple "bottom lines".¹¹¹ Of course, this sort of "narrative" business reporting raises difficult issues, as the UK government's recent

¹⁰⁸ Or perhaps, better, a number of different "sub-brands", such as charities, social enterprises, and so on.

¹⁰⁹ See for example, the essays in J Elster (ed), *Deliberative Democracy* (Cambridge University Press, 1998).

¹¹⁰ This has, of course, long been one of the principal advantages of the guarantee company form, through the content of their pro-forma constitution ("Table C").

¹¹¹ See eg R Kaplan and D Norton, *The Balanced Scorecard* (Harvard Business School Press, 1996); PR Niven, *Balanced Scorecard: Step by Step for Government and Nonprofit Agencies* (John Wiley and Sons, 2003).

efforts to achieve this in relation to listed companies make painfully clear.¹¹² But, once again, it is a difficulty that cannot be avoided, given the different roles that not-for-profits perform.¹¹³

Participation might also be facilitated, especially in larger organisations, by supplementing rights of attendance at formal meetings with rights to participate electronically, and by engagement outside of formal meetings. It is worth noting here, for example, that the UK government has shown some interest in adapting company law to the technical developments that the internet is making possible, and some modest steps have been taken to facilitate such developments.¹¹⁴ Regional or “devolved” democracy may also be more important: not only might regional meetings make participation easier, but members’ identification with the organisation might be with its local, rather than national, operations.

Participation through membership does not, of course, exhaust the possibilities of direct involvement in not-for-profits. It may be that membership is reserved for a relatively limited number of stakeholders, such as those who founded the organisation, its major donors, and so on. Or perhaps even where membership is open to all, there will be good reason why not all potential participants will choose to acquire that formal status. Organisations must, then, consider mechanisms enabling other non-member stakeholders to participate too, mechanisms that are proportionate to the interests in participation of these different stakeholders. There is, to be sure, an element of the prudential here. Good organisations will appreciate the advantages they might derive by facilitating the widest participation by their stakeholders. But the governance regime can do much – even if not by legal compulsion – to steer organisations down this road.

Participation Versus Control

Although participation by members (or indeed by other stakeholders) is likely to do something, instrumentally, to police not-for-profits, and to ensure that they hold fast to their own missions, still it is important to emphasise that “participation” is not the same as, and does not guarantee, “control”. Those who create a not-for-profit – including its “social entrepreneurs” – are likely to secure for themselves the initial control of the organisation. Thereafter, control may be spread somewhat more widely through the organisation as participation increases, but there are limits to this process. The exercise of full and effective control by all stakeholders would require a level of commitment greater than many stakeholders might wish to expend, *especially given* the non-instrumental motive behind much participation. Further, those managing organisations enjoy considerable power to manipulate the release of information so as to buttress their own position, however carefully disclosure regimes are prescribed. There is also the problem of expertise – or the lack of it. Control requires not only the acquisition and processing of information, but also the ability to understand what that information reveals.¹¹⁵ Moreover, unless control is to be entirely “negative” – preserving the status quo by blocking management’s proposals – stakeholders also need

¹¹² See the short-lived requirement on listed companies to publish an “Operating and Financial Review”: The Companies Act 1985 (Operating and Financial Review and Directors’ Report etc) Regulations 2005, SI 2005/101 and The Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005, SI 2005/3442. The requirement of a business review has now been reintroduced as Companies Act 2006, s 417.

¹¹³ For a discussion of some of the problems in providing fair and reliable measures of not-for-profit performance, see A Dunn and CA Riley, “Supporting the Not-for-Profit Sector: The Government’s Review of Charitable and Social Enterprise” *op cit*, at pp 634–9.

¹¹⁴ See *eg* the Electronic Communications Act 2000 and the provisions in the Companies Act 2006, Part 13.

¹¹⁵ JC Coffee, “Shareholders Versus Managers: the Strain in the Corporate Web” (1986) 85 *Michigan. Rev* 1, remains an excellent discussion of these issues (albeit in the context of for-profit companies).

to offer proposals of their own. Yet many stakeholders will lack sufficient business experience to judge managements' past record, or to suggest ways of improving its future performance.

These various difficulties are similar to those which face dispersed shareholders of widely-owned companies.¹¹⁶ Indeed, that comparison is revealing. The largest not-for-profits have memberships running into hundreds of thousands and more. The Royal Society for the Protection of Birds, for example, boasts a membership of over one million, whilst the National Trust has approximately 3.4 million members.¹¹⁷ Even in smaller not-for-profits, the number of their stakeholders will likely be much larger than the number of shareholders in a business firm with a similar sized turnover. Once we equate stakeholders with shareholders, we see that many not-for-profits are rather close to the "Berle and Means"¹¹⁸ corporation, with a large dispersed membership and beset by the separation of ownership and control.

If the above arguments are plausible, they suggest that not-for-profits are likely to be controlled, at worst, by their managers and, at best, by a relatively limited proportion of their stakeholders. And there is the risk then that such control will be abused, used to further the interests of those in control rather than the mission of the organisation itself. Against this conclusion, Ben-Ner and Hoomissen have sought to downplay the likely conflicts of interest between controllers and non-controllers.¹¹⁹ In particular, they argue that where the organisation must supply the same good, of the same quality, to both controlling and non-controlling consumers, then those consumers who happen to be in control will have little incentive to skimp on quality. By doing so, they would also reduce the quality of the service provided to themselves. The example Ben-Ner and Van Hoomissen suggest is a child-care organisation controlled by some of the parents of its enrolled children. If the organisation must supply the same quality of care to all children, then a non-controlling parent can be reasonably confident that controlling parents will be keen to maintain high standards.

However, there are several problems with this argument. First, it probably has less application to incompetence than to deliberately self-serving behaviour by those in control. A controlling-parent who is doing her incompetent best, and hurting her own child's quality of care, will likely find it more difficult to raise the standard of her behaviour (than to stop deliberately reducing the quality of care). Moreover, even where controllers and non-controllers alike must consume the same output, still controllers can use other means to favour themselves. They can tailor the (uniform) output so that it is more in tune with their own preferences, rather than those of non-controllers. They can use side payments to subsidise their own consumption, or they can inflate the expenses or remuneration they receive for participating at members meetings, and so on.¹²⁰ Finally, the "uniform output" argument also applies poorly to the situation where patrons donate money for the provision of goods or services to others. In those cases, there is not the sense of all patrons – controlling and non-controlling alike – sitting in the same boat to consume the same output.

¹¹⁶ See for example H Short and K Keasey, "Institutional Shareholders and Corporate Governance in the UK" in K Keasey, S Thompson and M Wright (eds) *Corporate Governance: Economic, Management and Financial Issues* (Oxford University Press, 1997).

¹¹⁷ See <http://www.nationaltrust.org.uk/main/w-trust/w-thecharity.htm>.

¹¹⁸ AA Berle and GC Means, *The Modern Corporation and Private Property* (Harcourt Brace, 1932)

¹¹⁹ A Ben-Ner and T Van Hoomissen, "Nonprofit Organizations in the Mixed Economy" *op cit* n 95 at p 35. They acknowledge that their argument draws on the work of M Olson, *The Logic of Collective Action* (Harvard University Press, 1971).

¹²⁰ This is not to say that controllers cannot charge differential prices if that furthers the organisation's objectives. The point is only that controllers might act abusively in so doing.

Given that, it remains necessary to impose constraints upon the exercise of control by members, including in particular the imposition of fiduciary obligations upon them. They ought to be required to exercise their votes in the best interests of the organisation, rather than in their own sectional interests. So doing would represent a departure from the position that UK company law has historically taken in respect of for-profit organisations. Aside from some exceptional cases,¹²¹ members of for-profit companies are entitled to vote in their own self-interest.¹²² Finally on this point, it is worth emphasising how widely this requirement would penetrate inside corporate governance structures. Besides obvious examples, such as the right to hire and fire directors, or to change the company's constitution, it would apply also in relation to those areas where approval of managerial action is required,¹²³ to derivative actions, and even to proceedings under the unfair prejudice regime of sections 994–995 of the Companies Act 2006.

Board Structure

Given the gap between participation and control, attention must also be given to the *composition* of the board. Within the UK, most recent attention to board composition has followed from the work of the Combined Code on Corporate Governance,¹²⁴ with its emphasis upon non-executive directors. Here, the guiding aim has been to secure a sufficiently strong presence¹²⁵ of non-executives who are independent of the company's management. Independence is defined essentially negatively, with a number of relationships with management being specified as precluding independence.¹²⁶ The assumption is that in the absence of such relationships, the non-executive is likely to be an adequate representative of the interests of shareholders. It is questionable whether this same approach can be appropriate for not-for-profits. Although a good deal of governance attention on not-for-profits has focussed on the independence of boards, it is arguable that the board must be not only independent of management, but also more closely representative of the variety of interests that not-for-profits accommodate. Rather than merely expecting a disinterested board paternalistically to decide what is in the best interests of different beneficiaries, the board can itself become a more democratic organ.

CONCLUSIONS

Not-for-profits are difficult organisations to pin down. Their very name adds to the temptation to define them by what they are *not*, rather than by what they are. Yet we must understand the positive role they play if we are to develop a proper account of the purpose of their governance regime. To be sure, they take up some of the "slack"

¹²¹ Perhaps the most familiar is a shareholder resolution to alter a company's articles of association, which must be passed "bona fide for the benefit of the company as a whole"; *Allen v Gold Reefs of West Africa* [1900] 1 Ch 656. See also *Clemens v Clemens* [1976] 2 All ER 268 for a rare case in which this principle was applied outside of the context of an alteration of the articles.

¹²² See *eg North-West Transportation Co Ltd v Beatty* (1887) LR 12 App Cas 589. This principle can also be seen to underpin those cases in which shareholders' voting agreements have been upheld; see *eg Russell v Northern Bank Development Corp Ltd* [1992] 1 WLR 588, [1992] 1 BCLC 1016; CA Riley, "Vetoes and Voting Agreements: Some Problems of Consent and Knowledge" (1993) 44 *NILQ* 34.

¹²³ See Companies Act 1985, Part X.

¹²⁴ *Op cit.*

¹²⁵ The Combined Code now recommends, for Listed Companies, that one half of the board (excluding the Chair) be independent non-executives; see provision A.3.2. Smaller (sub-FTSE 350) companies are recommended to have at least two independent non-executives.

¹²⁶ Provision A.3.1.

where government is (increasingly) reluctant to provide or deliver. And they help to engender the trust of those who deal with them in virtue of the lock imposed upon their assets. But as important as those aspects are, not-for-profits are still more than that. They are participatory communities. Some participation is instrumental – aiming for control of the organisation the better to ensure that the demands of those dealing with them for the goods or services they produce are effectively delivered. And some participation is “expressive” – allowing the participant to discover, or to proclaim, who she is, or who she would like to become. The challenge that the governance of not-for-profits must meet is to accommodate these multiple organisational roles.